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International Franchising/Multilevel Marketing: Effect of Intellectual Property, Securities and Corporate Laws on Product Franchises and the Emergent Relationships

Contents

I. Introduction

A. Abstract

International franchising gives rise to problems such as passing off, forced agency and unfair competition. These problems exist primarily because the international treaty on intellectual property is not enforceable as law in some member countries for various reasons. In Nigeria for instance, business names and trademarks, not registered under the Companies and Allied Matters Act and Trade Marks Act are not recognized as being *in rem* and, for treaties to be enforceable as law, the constitution requires ratification by the National Assembly. Thus, international franchises that need intellectual property protection suffer greatly in their peculiar form of relationships.

This paper shall explore how the tripartite relationships created by a Franchise Agreement may result in agency sought to be avoided by franchisors. Such an agency relationship will however require disclosure from the controlling party rather than from the agent. The relationships also contemplate consumers who benefit from laws and regulations that protect against misinformation and marketing of unsafe products. Such laws and regulations include Securities Acts, Trade Commissions Regulations and Trade Marks laws.

Corporations in the franchisees country that bear the same or similar names and are more conversant with their business environment may pose such a threat to the franchisee that it may compel increased control and protection by the Franchisor sometimes sought after by the Franchisee. The problem with increased control is that it results in an agency relationship potentially making the franchisor vicariously liable for the acts of the franchisee. The potential for litigation based on the actions of the agent may discourage Franchisors and lead to failure of such businesses abroad. Perhaps there is the possibility of using a disclaimer to raise consumer confidence and to guide the public to the proper Franchisee. One example of such a franchise is the Multilevel Marketing Form of Distributorships. Because such distributorships may be considered "accidental franchises" under the Federal Trade Commission's Trade Regulation Rules (FTC Rule) notwithstanding the labels in the contract, even without increased control sought after by the franchisee, a forced agency may be created.

Franchising expands the global market by promoting and marketing products without actually being established in foreign countries. This purpose may be defeated unless countries that have regular reciprocal foreign franchise investment contracts agree on an international trade marks list to ensure uniformity and avoid problems of unfair competition. Unlike the list published by the World Intellectual Property Organization (WIPO), this list can only be effective if all the member states enforce the treaties as signed.

By the end of this paper, I hope that using Nigeria as a case study will illustrate that international conventions and treaties should not inspire automatic foreign investment without ensuring that signatories are immediately enforcing them as part of their local legislation, as this may lead to frustration.

B. Scope of the Paper

This paper is limited to the effect of laws governing International Franchises. The effect being to create an agency relationship advertently or otherwise, in a foreign country where there is a company registered in the same or similar name passing its products off as that of the Franchisor or holding itself out as agent thereof. Considering the limited impact of membership of International Organizations governing these transactions and a franchisors need to protect the integrity of its marks of trade, this paper shall explore what problems a Franchisor/Manufacturer may have to contemplate when deciding how and whether to increase or moderate control over its franchisees.

II. Pervading Issues

A. Intellectual Property

The World Intellectual Property Organization lists the following as Intellectual Property: trademarks, service marks, commercial names and designations, including the rights relating to protection against unfair competition.[1]

> Trademark under Nigerian law means a mark used or proposed to be used in relation to goods, for the purpose of indicating or so as to indicate a connection in the course of trade between the goods and some person having the right either as proprietor or as registered user to use the mark, whether with or without indication of the identity of that person[2].

Therefore, Trade mark usage in Nigeria relates to goods only, apparently excluding services. This limited definition of trademarks recognizes unidentified parties. Under theory of agency, such an unidentified party would be an undisclosed principal. This is a unique feature of the Nigerian Trade Marks law.

Non-registration prevents the franchisor from obtaining injunctive relief or recovering damages for the infringement of that trademark, though the franchisor reserves a right of action against any persons passing off the franchisors goods as their own.[3]

B. Franchise

There is no internationally recognized definition of a franchise. But basic expectations of franchising are the same in almost all jurisdictions. Franchises require a party who owns a business model or registered mark to grant the right to use it to a party to the agreement for a fee. With this background and without feigning any special knowledge of the definition of a legal

[1] Art. 2, Convention Establishing the World Intellectual Property Organization, Stockholm, July 14 1967 as amended on September 28, 1979.
[2] Section 67(1), Trade Marks Act, Cap. 436, Laws of the Federation of Nigeria,1990.
[3] Section 3, Nigerian Trade Marks Act.

creation as variable in its forms as a franchise, but having considered some definitions that follow[4] a feeble attempt can be made to formulate a definition.

In its broadest form, franchising is the creation of a contractual relationship between the owner of intellectual property, called a franchisor and the person granted the right to use, sell, distribute or market products or services that are the subject matter of the particular contract(s) with significant assistance and control of the franchisees business operations by the franchisor, for monetary consideration, subject to any statutory restrictions or guidelines which may form part of the terms of the agreement[5]. By this definition, a franchise could be said to serve the purpose of saving the franchisor from entering a foreign market to establish a business by investing money, time and labor to create a business that the franchisor has to operate. Rather, having established a successful business model and recognized lucrative trademark, the franchisor passes the burdens of operating a business and the minimized risk of failure to the franchisee. The risk is minimized because the franchisor undertakes to assist the franchisee and control some of its business operations.

Franchising is a United States creation that dates back as far as the 1850's when Isaac Singer obtained a patent for his improvement of an existing model of a sewing machine.[6] Naturally, the place to obtain a proper definition of franchising would be United States Law, Federal and State. In the United States, depending on the transaction, franchise relationships are defined either by the law creating such relationships or by common law principles. For instance, a relationship created for the purpose of motor fuel marketing or distribution between a franchisor and franchisee is defined by the Petroleum Marketing Practices Act.[7]

The Federal Trade Commission's Trade Regulation Rules (FTC Rules) defines relationships that constitute a franchise as any continuing commercial relationship or arrangement whatever it may be called, in which the terms of the offer or contract specify, or the franchise seller promises or represents orally or in writing that the franchisee will obtain rights to business use of marks identified with the franchisor allowing the franchisor significant control of the franchisees operations for a required payment to the franchisor.[8]

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[4] Warren Pengilley, *International Franchising Arrangements and Problems in Their Negotiation*, 7 Nw. J. Int'l L. & Bus. 185, 187-88 (Fall/Winter 1985); "Franchise means a contract or other arrangement governing the business relationship within this state between a franchised distributor and a franchisor where the franchised distributor is required to pay more than $100 to enter into such contract or other arrangement provided that a franchised distributor as defined under subdivision (2) (d) of this Section shall not be required to have paid any consideration to enter into such contract or relationship". 6 Del. C. Ann. §2551(1).

[5] 16 C.F.R. §436(h); Michele Lee, *Franchising in China: Legal challenges when first entering the Chinese Market*, 19 Am. U. Int'l L. Rev. 949, 955-56 (2004); See also, Philip F. Zeidman, *Franchising and Other Methods of Distribution: Regulatory Pattern and Judicial Trends*, 2008 Practicing Law Institute, Corporate Law and Practice Course Handbook Series, PLI Order No. 14482, January-February, 2008, 475 at 481.

[6] Wikipedia, the free encyclopedia, "Franchising: History"; http://en.wikipedia.org/wiki/Franchising#cite_note-21

[7] 15 U.S.C. § 2801(2): the term "franchise relationship" means the respective motor fuel marketing or distribution obligations and responsibilities of a franchisor and a franchisee which result from the marketing of motor fuel under a franchise.

[8] 16 C.F.R. § 436(h); See also, Philip F. Zeidman, *Franchising and Other Methods of Distribution: Regulatory Pattern and Judicial Trends*, 475 at 481.

Several states of the union have franchise laws that require registration of franchise offerings and/or require disclosure to prospective franchisees including filing of documents. What laws have to be complied with depend on whether the franchise is affected by a state legislation's requirement for disclosure or the FTC rule.[9]Delaware, for instance does not have any disclosure requirement and a franchisor registered there would only have to comply with the FTC's disclosure requirement. However, though our case study below covers a Franchisor incorporated in Delaware, Delaware law will not apply to a foreign distributorship contract because it requires that a Franchisee/Distributor have a place of business within the state to meet the definition of a Franchise.[10] Delaware Law is however relevant because it provides a statutory distinction between a franchise and a pyramid scheme. The main distinction between a Franchise and a pyramid scheme, which is illegal is that the pyramid scheme requires fulfillment of a condition to part with money or a thing of value prior to the issuance of the right to use the franchisors mark and though like a master franchise agreement it allows the master franchisee to offer its mark to sub-franchisees, the pyramid scheme continues to require a conditional parting of some advance fee prior to joining the chain of distributorship.[11] Either way, the federal regulation directly impacts the establishment of a franchise because it requires that every franchisor deliver to any prospective franchisee what the proposed franchise agreement entails, as well as a detailed disclosure document before the sale of the franchise, but does not require that the commission approve any documents or that any documents be filed with the commission[12].

The FTC's disclosure rule only affects two kinds of relationships deemed to satisfy the advisory opinions requirement for a continuing commercial relationship. The two kinds of relationships are Package Franchising and Product Franchising. While Package franchises are those in which the franchisor licenses the franchisee to do business under a prepackaged business format established by the franchisor which is closely identified with the franchisor's trademark,[13] Product franchises are those in which the goods manufactured by the franchisor and bearing its mark are distributed by the franchisee while under the control or direction of the franchisor.[14]

In this paper, the multilevel marketing distributorship is solely concerned with product franchises because the franchisee markets goods manufactured by the franchisor and which bear the franchisors mark either as a partial sale of goods or for sale and recovery of the purchase price after the goods have been sold by the franchisee. This use of the trade mark would meet the definition under the Nigerian Trade Marks Act in its sole relation to goods but not to the packaging.

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[9] Philip F. Zeidman, *Franchising and Other Methods of Distribution: Regulatory Pattern and Judicial Trends*, 2008 Practicing Law Institute, page 481.

[10] 6 Del. Code Ann. §2551(2); §2561(2) defines a pyramid or chain distribution scheme as a sales device whereby a person upon a condition that the person part with money, property or any other thing of value, is granted a franchise license, distributorship or other right which person may further perpetuate the pyramid or chain of persons who are granted such franchise, license, distributorship or right upon such condition.

[11] *Id.* A limitation as to the number of persons who may participate, or the presence of additional conditions upon the eligibility of such a franchise, license or distributorship or other right to recruit or upon the receipt of profits there from, does not change the identity of the scheme as a pyramid of chain distribution scheme.

[12] *Id.* at 482

[13] *Id.* at 483

[14] *Id.*

The definition of product franchises is encompassed by the term Business Format Franchises. In business format franchising, a wide range of goods and services are offered under the franchisors trade name and format.[15]Here, the franchisor provides not only its product and trademark but also its marketing strategy, operating manuals, quality control and communications system.[16]The benefit to the franchisor of offering a business format franchise is the control of the quality of the products and maintenance of a chain of businesses which are uniform in appearance as well as in operation, because this causes the public to turn with confidence to franchise stores for the product.[17]The problem with business format franchising is that the level of control of the franchisor over the operation of the franchise is so high that it becomes an investment contract governed by the Securities Act of 1933.

C. Securities

Like the FTC Rule, the Securities Act of 1933 requires disclosure of certain information by means of a registration statement and a prospectus prior to the sale, or offer for sale, of securities falling within the scope of the Act by persons within the scope of the Securities Act.[18] Also like the FTC Rule, persons anticipated by these provisions are the issuers of such securities including natural and corporate persons who issue or offer securities for sale.[19]

The Nigeria Stock Exchange Commission regulates securities dealings in Nigeria and was formed in preemptory reaction to the problems of the United Stock Markets that resulted in the passing of the United States Securities Act of 1933 and Securities Exchange Act of 1934.[20]The provisions of these statutes are *in pari materia* with Nigerian Law which was adopted *verbatim* from the Securities Act of 1933.[21] The law governing securities in Nigeria is the Securities and Exchange Commission Act, 1988 and it derives its control of securities dealings from Section 541 of the Companies and Allied Matters Act. [22]

Nigerian Courts have not had the opportunity to adjudicate over matters of securities dealings so United States Court decisions are considered to be highly persuasive in interpreting any laws relating to investment. In fact, *U.A.C. Offoboche* noted that neither the Securities and Exchange Commission Act nor the Companies and Allied Matters Act define what securities are but like their U.S. counterpart, merely list the instruments that are part of the class; identifying "security" as embracing investment contracts. [23] It follows, therefore that in an international franchise relationship between a Nigerian franchisee and United States franchisor, U.S. law will

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[15] *Lads Trucking Co. v. Sears, Roebuck & Co.*, 666 F. Supp. 1418 (C.D. Cal. 1987).
[16] *Westfield Centre Serv., Inc., v. Cities Service Oil Co.*, 86 N.J. 453, 432 A.2d 48 (1981).
[17] *See generally, Susser v. Carvel Corp.*, 206 F. Supp. 636 (S.D.N.Y. 1962), judgment aff'd, 332 F.2d 505 (2d Cir. 1964).
[1818] §§ 6 and 7(a) of the Securities Act, 1933.
[19] *Id.,* §§2(a) (2) and 2(a) (4).
[20] See generally, Ugalahi Agbo Claire Offoboche, *Registered Company Transactions and the Nigeria Stock Exchange Law in Practice*, Long Essay in fulfillment of requirements for Bachelor of Laws, Ahmadu Bello University Faculty of Law, July 1998 (Unpublished), Pages 5-6.
[21] *Id.*
[22] *Id.* Offoboche U.A.C., *Registered Company Transactions and the Nigeria Stock Exchange law in Practice*, Page 15
[23] *Id.* at Page 55-56.

be instructive when it comes to interpretation of franchise contracts which are found to be securities because they are investment contracts.

Under U.S. law, an investment contract is a security if an investment is made in a common enterprise which is premised upon the reasonable expectation of profits solely from the managerial or entrepreneurial efforts of others.[24] An investment contract and therefore a security within the meaning of the Federal Securities Act can exist where the investor is required to perform some duties, so long as they are nominal or limited and would have little direct effect upon receipt by the participants of the benefits promised by the promoters.[25]

As such, some franchises may be inundated with such control on the part of the franchisor that the franchise becomes an investment contract especially where the franchisee as Master franchisee has the duty of procuring other sub-franchisees to expand the franchisor's chain of business. [26] One example is a case involving the sale of franchises for a food distribution service, in which the franchisees would receive payment for obtaining further franchisees, and for retail sales by sales personnel, supposedly employed by the franchisees but actually employees of the franchisor, which recruited, trained and paid them; the prospective franchisees were being asked to invest substantial sums in the operation where the essence of the consideration received was not products or otherwise useful training but simply the opportunity to earn money if the efforts of others, the franchisor's management and sales people, proved successful.[27]

However, not all franchises are investment contracts and therefore not securities within the meaning of § 2 of the Securities Act. For instance, where, although the franchisor retained the power to specify the décor of the store, the operating hours, the location of the store, the quality of the merchandise, and the arrangement of the store and window displays, the franchisee nonetheless retained duties with respect to everyday functioning of the store, such as the hiring and firing of personnel, maintenance of good customer relations and day to day salesmanship; under that arrangement, the efforts of the franchisee would contribute substantially to the success or failure of the venture and the decision making and responsibilities left to the franchisee were not nominal, with the result that the franchisee was not led to expect profit solely from the efforts of the promoter.[28]

The Securities Act provides that any person who by or through stock ownership, agency or otherwise controls any person liable under Sections 77k or 77l of title 15 shall also be liable jointly and severally with and to the same extent as such controlled person is liable, unless, the controlling person had no knowledge of, or reasonable grounds to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist. [29] This is a statutorily created doctrine called "control person liability".[30] It expands the theories of

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[24] *Id.* (Citing *Felts v. Nat'l Account Sys's Assoc. Inc.*, 469 F. Supp. 54, 63 (D.C. Miss. 1978).

[25] *Lino v. City Investing Co.*, 487 F.3d 689 (3d Cir. 1973), disagreed with on other grounds by Kansas State Citizens Bank of Windsor (CA 8 Mo.) 737 F.2d 1490, CCH Fed. Secur. L.R.,para 91554).

[26] *Id.*

[27] *See, S.E.C. v. Galaxy Foods, Inc.*, 417 F. Supp. 1225 (E.D.N.Y. 1976) aff'd, 556 F.2d 559 (2d Cir. 1977).

[28] *Plum Tree, Inc. v. Frasz*, 433 F. Supp. 537 (E.D. Pa. 1977); *Keith A. Rowley*, § 3, 11 Causes of Action 2d 1 (2008).

[29] Section 20(a), Securities Act, 1933.

[30] *Keith A. Rowley*, § 3, 11 Causes of Action 2d 1 (2008)

respondeat superior and vicarious liability as applied to agency relationships to create an additional avenue of secondary liability for violation of federal and state securities laws.[31] The practical import of this doctrine is that a plaintiff seeking to hold a control person liable need not sue the primary violator in order to do so.[32] Control under the Securities and Exchange Commission's Rule 405 is defined as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.[33]

The requirement to be met by the franchisor in an investment contract is registration of the securities under the Securities Act which entails disclosure, like under the FTC Rules, but by means, instruments of transportation or communication in interstate commerce, which contain facts that the franchisor knows to be true.[34] The consequence is that a franchisee who receives false information from the franchisor would be entitled to recover the consideration paid for such security with interest, less the amount of any income received or for damages if the franchisor no longer has rights to operate the franchise.[35] Thus, a franchisor who controls the operation of the franchise to the extent that it can be defined as an investment contract is subject to liability as a control person if he violates § 12(2) of the Securities Act of 1933 but will not receive the same protection if the franchisee violates these provisions because by making the responsible party under this section, the "person who offers or sells a security…", § 12(2) only protects the "person purchasing such security…"[36]

The Securities Act contemplates application of its provisions to trade or commerce in securities because it defines the term "interstate commerce" to include transactions between any foreign country and any state or territory.[37] It also recognizes the possibility of an agency relationship arising from control by one party[38] in an investment contract in interstate commerce which business relationship could result in a franchise. The Restatement[39] is extensively used by courts to determine legal ramifications of agency relationships.

D. Agency

The kind of Franchise relationship determines whether the franchisee is the agent of the franchisor or not. This is an important problem that must be addressed as part of the contract because it determines whether the franchisor as principal is vicariously liable to consumers for the acts of the franchisee as agent carried out within the scope of his authority whether disclosed

[31] *See, Johns Hopkins Univ. v. Hutton*, 297 F. Supp. 1165, 1212 (D. Md. 1968), judgment aff'd in part, rev'd in part on other grounds, 422 F.2d 1124 (4th Cir. 1970).
[32] *Keys v. Wolfe*, 540 F. Supp. 1054 (N.D. Tex. 1982), judgment rev'd on other grounds, 709 F.2d 413 (5th Cir. 1983).
[33] 17 C.F.R. § 230.405 (f) (1997); *Pharo v. Smith*, 621 F.2d 656, 670 (5th Cir. 1980), reh'g in part on other grounds, 625 F.2d 1226 (5th Cir. 1980).
[34] § 12(2) Securities Act of 1933.
[35] *Id.*
[36] See generally, § 12(2) Securities Act, 1933.
[37] 15 U.S.C.A. §77b (a) (7).
[38] Section 20(a), Securities Act, 1933
[39] Restatement (Second) of Agency (1958).

or not. In fact, a court has opined that the statements and restatements of the law of agency tend to obscure the effect of law on commercial dealings.[40]

Courts have used the Restatement's[41] definition that an agent is one who acts on behalf of some person, with that person's consent and subject to control.[42] An agent could be a person authorized by another to transact business or manage some affair for that other person or entity,[43] or is one who consents to the control of another to conduct business or manage some affair for the other, who is the principal. The proper functioning of the duties of an agent actually depends on the existence of such third parties. [44]For the purpose of this paper, such third parties could be the consumer who purchases the product from the franchisee or the sub-franchisee who enters into the franchise agreement under the master franchisee.

An agency relationship cannot be presumed and the burden of proof is on the party asserting the existence of the relationship.[45] The parties to an agency relationship are the principal and the agent and an agent cannot exist without a then – existing principal. [46] The relationship of principal and agent must contemplate these third parties because between them and the principal, legal obligations are likely to arise, be modified or otherwise affected by the acts of the agent.[47]

The principal could be disclosed or undisclosed and this distinction impacts a principal's potential liability to third parties and the agent's personal liability. The rule that a principal is liable for the acts of an agent carried out within the scope of the agent's authority applies to an undisclosed as well as to a disclosed principal.[48]And the fact that an agent acts in his or her own name without disclosing the principal does not preclude liability of the principal when discovered to be such by the third party.[49]

A key feature of an agency relationship is the existence of control by the principal over the activities of the agent.[50] The right of control includes the right to dictate the means and details of the agent's performance.[51] It is this level of control that distinguishes an agent from an independent contractor, so that if the principal controls what shall be done but not how, then the person employed acts as an independent contractor.[52] For instance, no agency relationship was found where evidence did not show that a party that promotes and markets products of its own and those of another company have the means and details of the promoter's work controlled, though the contractor did not always make it clear to his customers that he was an independent

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[40] *Oil Supply Co. Inc.*, 726 N.E.2d at 249-50.
[41] § 1(1) Restatement 2d of Agency
[42] *Oil Supply Co. Inc., v. Hires Parts Serv. Inc.*, 726 N.E.2d 246, 247 (Ind. 2000).
[43] See, *Novamerican Steel, Inc. v. Delta Brands, Inc.*, 231 S.W.3d 499, 511 (Tex. App. Dallas 2007)
[44] *Id.*
[45] *Schott Glas v. Adame*, 178 S.W.3d 307, 315 (Tex.App.-Houston 14th Dist. 2005).
[46] *C & H Contractors, Inc., v. McKee*, 177 So.2d 851 (1965), *Saums v. Parfet*, 258 N.W. 235 (1935)
[47] *Id.*
[48] *U.S. v. Everett Monte Cristo Hotel, Inc.*, 524 F.2d 127 (9th Cir. 1975).
[49] *Lee v. YES of Russellville, Inc.*, 784 So. 2d 1022 (Ala. 2000).
[50] *Elk River, Inc. v. Garrison Tool & Die, Ltd.*, 222 S.W.3d 772 (Tex. App. Dallas 2007), reh'g overruled, (May 15, 2007
[51] *Novamerican Steel, Inc.*, 231 S.W.3d at 511.
[52] *Schott Glas*, 178 S.W.3d at 315.

contractor.[53] There is therefore a need in a franchise relationship for the franchisor to retain some control over the franchisee but must balance the level of control so that it is sufficient to protect the franchisors trademark but not enough to subject the franchisor to vicarious liability or *respondeat superior*, depending on the theory of law upon which the suit is brought.

In determining whether defendant, as franchisor, may be held vicariously liable for the acts of its franchisee, the most significant factor to consider is the degree of control that the franchisor maintains over the daily operations of the franchisee.[54] Significantly, a plaintiff must offer proof raising a question of fact as to the issue of day-to-day control over maintenance and management by the Franchisor.[55] What level of control will make a franchise, an investment contract rendering it subject to securities laws depends also on the facts. Courts typically draw distinctions between recommendations and requirements,[56] being mindful that a franchisor has a legitimate interest in retaining some degree of control in order to protect the integrity of its mark.[57]Recommendations are unlikely to result in an agency relationship but stringent requirements will. Thus, an agency may be found when a franchisor requires a franchisee to hire, train and supervise employees in accordance with extensive guidelines and where the franchisor reserves the right to impose discipline upon the employees engaging in discriminatory acts.[58]

III. Problems Arising

A. Setting the Stage: A Hypothetical Situation

Assuming a legal consultant on International Franchise Transactions received the following letter from a client law firm requesting information on how to advice their new clients, this paper is premised on what information their clients require and why. This hypothetical situation also serves to limit the scope of this paper.

From: *Pulloma, CEO of Noni World Wide Inc.*

To: Action, Brag, Calm and Associates, LL.P

Noni has offices and distributorships in various states in the United States of America and was incorporated in Delaware. We have made contact with several persons in foreign countries that are signatories to WIPO via the internet including Okidoki Foods Inc. in Nigeria. Okidoki issues the right to distribute our Noni Juice extract and other Noni products to several persons with whom we have no contact. If the fee on all sales of distributed Noni products is paid on time by

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[53] *See generally*, 178 S.W.3d 307.
[54] *Andreula v Steinway Baraqafood Corp.*, 243 A.D.2d 596, 596 [1997]
[55] *Hart*, 304 A.D.2d at 1059.
[56] *Wendy Hong Wu v. Dunkin Donuts, Inc.*, 105 F. Supp. 2d 83 (E.D.N.Y. 2000), judgment aff'd, 4 Fed. Appx. 82 (2d Cir. 2001).
[57] *Raines v. Shoney's Inc.*, 909 F. Supp. 1070 (E.D. Tenn. 1995)(holding that the protection of the trademark and service mark is the necessary duty of the franchisor). *See also,* John Bourdeau Et Al, 62B Am.Jur. 2d Private Franchise Contracts, § 298.
[58] *Miller v. D. F. Zee's, Inc.*, 31 F. Supp. 2d 792 (D. Or. 1998).

Okidoki, then the arrangement may continue, and we will pay Okidoki a 3% service fee for each new sub-distributor.

However, recently, for the purpose of uniformity, we have been bombarded by requests for added control with regard to the structure of the buildings, positions of signs, instruction manuals to be given to employees of the various sub-distributors, including what business model to use as well as how and what to train the staff about. These would include security requirements and how to greet customers when they enter the stores. Okidoki, for itself and on behalf of its Sub-distributors has notified us that this is a necessity because there is another company registered in the name of Noni World Wide Ltd that also sells Noni Juice Products packaged with a similar green leaf label and bearing the words "Noni Juice".

We would like your advice on what to do? How can we protect our trade mark in a foreign country where there already exists another corporation with the same name conducting the same or similar business? Should we attempt to buy into the company or is a public disclaimer sufficient to warn consumers that these products are neither produced nor marketed by us or our distributors? Should we set up training facilities in Nigeria? If we opt to do this, what impact will it have on our responsibilities toward the distributor, subsidiary and the consumer? Would it make any difference if these instructions are issued online and training is completed online?

B. Effect of the Relationship Created by the International Business Transaction

The international business transaction above involves a franchise contract that is affected by various laws. Noni Juice World Wide Inc. (Noni) needs to know whether the level of control proposed by Okidoki will subject it to vicarious liability for the acts or contracts entered into by Okidoki. Noni's anxiety justly arises from its need to protect the integrity of the Noni Juice trade mark and to retain its profit making venture in the international market. Noni has contracted the right to use its trade mark in relation to the distribution and sale of goods in Nigeria to Okidoki. Because the contract for trade mark use is in relation to goods, the Nigerian Trade Marks Act applies.[59] Noni ought to have registered its trademark under the Nigerian Trade Mark Act in order to obtain injunctive relief or recover damages for any infringement by the rival company Noni World Wide Ltd (Ltd). If it has not already done this, then it loses these rights against the Nigerian Company for infringement of its mark. [60]It may however bring suit against them for passing off their goods as its own.[61]

The next question is whether the Noni and Okidoki have a franchisor-franchisee relationship or whether this a pyramid scheme? Noni owns a registered mark for health supplements bearing a trademark that it has granted to Okidoki to use for a fee. This has created

[59] Section 67(1), Nigerian Trade Marks Act.
[60] Nigerian Trade Marks Act, Section 3.
[61] *Id.*

a contractual relationship in which it retains some control over Okidoki's business operations for the purpose of protecting the integrity of its mark and rendering assistance to Okidoki. In keeping with my proposed broad definition, it may be safe to conclude that this is a franchise contract. This leads to the question of whether Noni should attempt to buy into the competing company or whether a public disclaimer would be sufficient to warn consumers that Ltd's products are neither produced nor marketed by Noni.

The purpose of creating a franchise being to avoid physically entering the market would be defeated if Noni were to attempt to buy into Ltd. Besides, since Ltd is a local company, it may be more familiar with the business terrain than Okidoki especially if it is well established in Nigeria. More so because the requests for increased control sought by Okidoki shows that it is threatened by Ltd's presence and would like to have the backing of a more internationally recognized corporation like Noni to favorably increase its chances of competing. Increasing control with regard to the physical structure of the business, and uniformity in advertising may be ways to give Okidoki a fair chance to compete. Any advertising campaign is likely to succeed if it contains a clear disclaimer of the products being passed off. But because balancing the level of control is essential to avoiding an agency relationship Noni would be well advised to recommend but not require Okidoki to advertise locally using imaginative ways like hand bills, auto and electric-pole advertising to reach consumers in the grass roots as well as the usual Television, Radio and Internet advertisements.

Pyramid schemes being illegal, Noni must ensure that the relationship created does not require the continuous conditional parting of any advance fee prior to sub-franchisees being recruited by Okidoki on its behalf because this will make the agreement a pyramid scheme. The advance fee precluded from franchise agreements do not invalidate the right of the franchisor to recover required payments such as royalties and profits from the franchisees based on the distribution of the products. So long as the 3% service charge required from sub-franchisees is not continuous, Noni will not have created a pyramid scheme.

Since the FTC Rule regulates franchise contracts, Noni ought to have complied with the requirements for disclosure at the time of contracting with Okidoki.[62] The disclosure rule applies to continuing commercial relationships which could be either package franchising or product franchising.[63] The rule will only apply if Noni and Okidoki's relationship created either a package franchise or a product franchise. The disclosure rule affects Noni because, as distinct from a package franchise in which Noni would have licensed Okidoki to do business under a prepackaged business format established by it, the fact that Okidoki is requesting increased control, and the contract terms show that Okidoki was authorized to distribute goods manufactured by Noni and bearing its mark while under the control and direction of Noni, leads to the conclusion that this is a product franchise. Since the Nigerian Trade Marks Act is solely concerned with franchises relating to goods[64], trade marks for use by product franchises are covered there under.

However, product franchises are further encompassed by the term business format franchises. A business format franchise would require that Okidoki offers a wide range of goods

[62] See Zeidman, PLI at 481.
[63] 16 C.F.R. §436(h)
[64] Section 67(1) Securities Act 1933.

under Noni's trade name, and Noni provides not only its products and trademark but also its marketing strategy, operating manuals, quality control and communications' systems.[65] Okidoki's request for increased control by Noni, in the areas of advertising such as uniformity in building structures, positions of signs, and training issues like how to greet customers and what security requirements to use; are likely to bring this agreement under the umbrella of a business format franchise, especially since, they require Noni to provide instruction manuals for employees as well.

Noni benefits[66] from offering business format franchises because it controls the quality of the products and maintains a chain of businesses which are uniform in appearance as well as in operation, because this causes the consumer to turn to franchise stores like Okidoki for Noni's products. Thus, Okidoki's request for increased control for the purpose of uniformity is reasonable unless Noni wishes to abstain from the possibility of creating an investment contract which will require compliance with the Securities Act of 1933.

The Securities Act would require Noni to disclose certain information to be contained in a registration statement and prospectus if the franchise is an investment contract considered to be a security under the Securities Act. The Noni franchise will be an investment contract if Okidoki is considered to have made an investment in a common enterprise which is premised upon the reasonable expectation of profits solely from the managerial or entrepreneurial efforts of others.[67] Thus, complying with Okidoki's request for increased control may leave Okidoki with merely nominal or limited duties which will have very little direct effect upon the receipt by Okidoki of the benefits of investing in the franchise promised by Noni. Like *Lino,*[68] if Noni obliges Okidoki by training the personnel they may be considered employees of Noni; and if potential franchisees invest substantial sums in the operation then the essence of the consideration received, such as the 3% fee would simply be the opportunity for Okidoki to earn money, based on the efforts of Noni's management. A United States Court like the Third Circuit[69] may find this franchise to be an investment contract. Courts may not find an investment contract to exist if Noni ensures that Okidoki substantially contributes to the success or failure of the venture by retaining duties with respect to everyday functioning of the store, such as hiring and firing personnel, maintenance of good customer relations and day to day salesmanship because then Okidoki could not be led to expect profit solely from the efforts of Noni. [70]

Assuming an investment contract exists between Noni and Okidoki, the Securities Act recognizes that the element of control makes one party to the investment contract liable for the acts of another jointly and severally.[71] Of course control would involve Noni having the power, direct or indirect to cause the direction of the management and policies of Okidoki by contract or otherwise.[72]This would give rise to control person liability under §12(2)[73]that protects Okidoki

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[65] *Lads Trucking Co.*, 666 F. Supp 1418; *Westfield Centre Serv.*, Inc., 86 N.J. 453.
[66] *Susser*, 206 F. Supp. 636.
[67] *Felts*, 469 F. Supp. at 63.
[68] 487 F.3d 689.
[69] *Id.*
[70] *Plum Tree, Inc.* 433 F. Supp. 537.
[71] § 20(a), Securities Act, 1933.
[72] S.E.C Rule 405.
[73] Securities Act 1933.

from the effects of falsifying information but Okidoki will not be liable if it misinforms Noni in any disclosure arising from the contract under this statute because the statute does not contemplate persons who purchase securities. All this is relevant to the contract between Noni and Okidoki because the provisions of the Securities Act apply to "interstate commerce" which is defined to include transactions with foreign countries.[74]

If Noni's contract with Okidoki becomes an investment contract then an agency relationship would be in existence. Noni would be the principal while Okidoki will act as agent under Noni's authority. In keeping with the tendency of the statements and restatements of the law of agency tending to obscure the effect of the law on commercial dealings,[75] it is important that Noni knows that an agency relationship will make it liable for contracts, advertisements placed and offers made to the public and to sub-franchisees by Okidoki. This is because the proper functioning of an agency relationship between Noni and Okidoki would depend on the existence of third parties. In this case, how to make consumers recognize the products offered by Okidoki as Noni's rather than that of its Nigerian Counterpart. Thus a sub-franchisee purchasing a distributorship right from Okidoki, being unaware of the existence of Noni, would still be entitled to collect damages, in the event of a breach by Okidoki, against Noni as the undisclosed principal.

Like Securities Laws, franchise laws require a high degree of control to make the franchisor a principal who would be liable for the acts of the agent.[76]While Noni may avoid liability under agency law by making recommendations to Okidoki concerning the matters raised, it will make itself principal in the relationship if the assistance it renders to Okidoki is in the form of requirements for the operation of the franchise.[77] Thus, Noni should require Okidoki to carry out acts only to the extent that they protect the integrity of the Noni Juice trade mark and assist Okidoki to succeed but should be careful to make only recommendations on all other aspects of the operation of the business. One suggestion would be for Noni to give Okidoki a business and training model to use but not to require that it be used for training personnel.

With the globalization of the market through the internet, it is doubtful whether courts will consider control to be less simply because training is carried out online. Perhaps the only advantage to Noni using the internet for training and advertising purposes is that it will give Noni an online opportunity to post a disclaimer to the public about the goods passed off by Ltd as that of Noni.

It will be wise for Noni to ensure that the Noni Juice trade mark has not been taken up by Ltd because then an injunction to restrain the use of the name Noni Juice can be obtained against Ltd. This is because there is a possibility that though Ltd is a registered business name, it may have failed to register its trade mark in which case the trade mark is still fair game for both parties.

IV. Conclusion

[74] 15 U.S.C.A §77b(a) (7).
[75] *Oil Supply Co. Inc.*, 726 N.E.2d at 249-50.
[76] *Andreula*, 243 A.D.2d at 596.
[77] *Miller*, 31 F. Supp. 2d 792.

Distributorship Franchises are a problem, notwithstanding Nigeria's membership in the World Intellectual Property Organization (WIPO) because, unless trademarks are registered under the Trade Marks Act, Nigeria does not recognize such marks as *in Rem*. It is therefore advisable for potential franchisors to have their marks registered in lucrative markets to ensure availability of those names when the time comes to expand.

Franchising gives rise to many problems. One such problem is passing off of locally made products with similar or the same trademarks as that of well recognized companies largely abroad. Acting with knowledge of the implications of added control and reliefs available to the consumer against the Franchisor, the Franchisor may register and market a new name for its product in the foreign country if it finds that market to be lucrative.

Another problem is that of distributors holding themselves out to be agents of the manufacturer which may create a vicarious liability situation because of the nature of control by the Manufacturer on the distributors. As illustrated, unless the parties can show factually that the franchise is not an agency relationship franchisors may be held liable for acts of the franchisees that are carried out within the scope of the distributorship agreement.

A more problematic aspect of holding out is how to deal with corporations who hold the rights to similar trademarks and are passing their products off as that of the Franchisor. Actual Franchisees are then left to compete with these products and may have to show more uniformity with the Franchisor's business model to convince wary consumers. Showing legitimacy of the products may require a greater level control of operations and structure of the products and services from the Franchisor. Balancing the degree of control by ensuring that some instructions are merely recommendations while others would be requirements may avert an inadvertent agency relationship.

These problems of passing off, forced agency and unfair competition arise primarily because the treaty on intellectual property is not enforceable as law in some of the member Countries. In Nigeria, the reason is that the constitution requires ratification of all treaties by the National Assembly before they can be enforced[78]. For the benefit of the consumer, who makes purchases online, a disclaimer posted on the website and in advertisements of the product pointing out the differences, may serve to raise consumer confidence especially in Multilevel Marketing Forms of Distributorships[79].

Some Manufacturers in the United States have created Multilevel Marketing distributorships which they call "international independent product consultants (distributors)" but as between the manufacturer and the distributor, they may actually be "accidental franchises" as defined by the FTC Rule.[80] The ripple effect of such a relationship may be to create a "forced agency" arising from the accidental franchise. Avoiding this situation may lead to the eventual

[78] Section 12, Constitution of the Federal Republic of Nigeria, 1999

[79] Not all Distributorships are necessarily Franchises.

[80] Accidental Franchises may be created by the relationship between the parties as defined under the FTC Rules notwithstanding the labels assigned the parties by the contract. This poses the problem of following applicable rules to meet the requirements of the FTC Rule which the Accidental Franchisor may be unaware. It becomes imperative then that an attorney representing any distributorship relationship properly examine the terms in accordance with the FTC Rule to ensure that the Franchisor knows the limits of his liability for the acts of the International Franchisee.

failure of the business abroad. Though a disclaimer may reduce the impact of this problem, the possibility of its occurrence may defeat the purpose of expanding the global market by use of Franchises. This is especially so because a Franchise is a perfect way to promote and market products without actually being established in foreign countries.

Local law can be a powerful determinant of what a potentially safe investment is in a foreign country. For instance, a distributorship contract of this nature could be a security for the purpose of securities laws and require disclosure by the issuing party who is the franchisor. Being a franchise, involving the use of trademarks, registration of such trademarks in the foreign country may be necessary, notwithstanding WIPO and other international treaties. The absence of knowledge about foreign law may render the transaction unenforceable in the foreign courts if such requirements are not met.

To ease foreign investment as such, countries that regularly conduct business of this nature within each other's jurisdictions should agree on an international trade marks list to ensure uniformity and avoid problems of unfair competition because many "Convention Countries" have either not ratified the treaty or are not enforcing them. International conventions and treaties should not inspire automatic foreign investment without ensuring that signatories are immediately enforcing the laws as part of their local legislation.